APPENDIX A-1

§ 337. Gain or loss on sales or exchanges in connection with certain liquidations

(a) General rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property defined.—

(1) In general.—For purposes of subsection (a), the term "property" does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition with respect to inventory in certain cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

(c) Limitations.—

(1) Collapsible corporations and liquidations to which section 333 applies.—This section shall not apply to any sale or exchange—

(A) made by a collapsible corporation (as defined in section 341(b)), or

(B) following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) Liquidations to which section 332 applies.—In the case of a sale or exchange following the adoption of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(1), this section shall not apply; or

(B) if the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2), this section shall apply only to that portion (if any) of the gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334(b)

(2)) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquidating corporation, of the property sold or exchanged.

APPENDIX A-2

§ 1.337-3. Property defined.—(a) Except as provided in section 337(b)(2) and this section, the term "property" as used in section 337(a) and § 1.337-1 does not include; (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as "inventory"), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed in this paragraph, the term "property" includes all assets owned by a corporation.

APPENDIX B-1

48 T. C. No. 78

TAX COURT OF THE UNITED STATES
D. B. ANDERS, Petitioner *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.
Docket No. 5094-64. Filed September 6, 1967.

An industrial laundry which provided a rental service of laundered apparels, coveralls, towels and other items, charged the cost of these items to expense when purcashed.

Most of the items had a useful life of 12 to 18 months, some longer depending upon how frequently washed and whether of seasonal use in the case of light or heavy materials. Some had the name of the employer-user and in some cases of the individual employee embroidered thereon. The corporation adopted a plan of liquidation under section 337, I.R.C. 1954, sold substantially all its property to a new corporation, and distributed its assets within 12 months to its sole stockholder. In arriving at the purchase price $233,000 was allotted to the rental items in circulating use, the cost of which had been charged to expense. *Held*: The gain realized upon the rental items in the liquidating sale is, pursuant to section 337, not recognized to the corporation.

J. Glenn Hahn and *Walter J. Kennedy*, for the petitioner.

Edward E. Pigg, for the respondent.

BRUCE, *Judge*: Respondent determined a deficiency in income tax of D. B. Anders, Inc., for the taxable year ended July 31, 1961, in the amount of $121,160 and notified petitioner that the deficiency and interest, constituting his liability as transferee of assets of the corporation, would be assessed against him. The sole issue is whether, in a liquidation under section 337 of the Internal Revenue Code of 1954, the corporation is entitled to the nonrecognition of gain on items, the cost of which has previously been deducted. Petitioner claims an overpayment.

FINDINGS OF FACT.

The stipulation of facts and the exhibits attached thereto are incorporated by reference.

D. B. Anders is an individual residing in Shawnee Mission, Kansas.

Service Industrial Cleaners, Inc. was a corporation organized in August 1947 under the laws of Kansas with its

principal offices in Kansas City, Kansas. At all times material its stock was owned by D. B. Anders directly or through his nominees. By amendment filed May 17, 1961, its name was changed to D. B. Anders, Inc. This corporation is referred to herein as "Service," or as the corporation.

Service filed a corporation income tax return for the fiscal year ended July 31, 1961, on an accrual basis, with the district director of internal revenue at Wichita, Kansas, on January 15, 1962, pursuant to an extension granted.

Service was engaged in the business of conducting and providing a rental service of cleaned and laundered towels, seat covers, fender covers, wiping materials and dust cloths, coats, coveralls, shirts, pants, and other textiles and apparels, including dusting and wiping equipment, sweeping tools, mops and accessories, herein referred to collectively as "rental items," as well as conducting a cleaning and laundering service of substantially the same type of items owned by others, and in general conducting an industrial laundry business.

For Federal income tax purposes Service charged to its expense accounts when purchased the cost of the rental items used in conducting its rental service business. At the end of each taxable year the expense accounts were credited with the costs of the ending inventory of items which had not been placed in service at the end of the taxable year.

In its taxable year ended July 31, 1961, prior to May 1961, Service had approximately 500 accounts to which it was furnishing laundry rental service. The average weekly gross income from rental and other laundry business was from $19,000 to $20,000. Some 13 percent to 20 percent of this was attributable to laundry of property of others,

referred to as NOG (not our goods). The remainder was attributable to laundry rental business.

The garment rental business was normally handled on a yearly contract basis. Service had about 40,000 garments in circulation. Most of the items had a useful life of 12 to 18 months, some longer, depending upon how frequently washed and whether of seasonal use in the case of light or heavy materials. Some had the name of the employer-user and in some cases of the individual employee embroidered thereon. Its garment customers included General Motors, Ford Motor Company, Trans World Airlines and Bendix, as well as garages, florists, filling stations, motor car dealers and small manufacturers. Its shop towel customers included railroads, pipelines, garages, filling stations, printers and paint factories. Union Pacific Railroad was serviced on a system-wide basis from Service's plants in Kansas City. Office buildings were the principal users of its dust control items. Service's replacement costs of these items averaged about $200,000 per year.

In May 1961 Anders reached an agreement for the sale of Service's business to a group of persons. The purchasers desired to carry on the business under a different corporation with the same name.

On May 12, 1961, the board of directors and the stockholders of Service adopted resolutions approving and authorizing the sale of the corporation's properties and business, changing the corporate name to D. B. Anders, Inc., and adopting a plan of complete liquidation pursuant to the terms of section 337 of the Internal Revenue Code of 1954.

As of May 16, 1961, Service entered into an "Agreement of Sale" with Albert Gitlow, Abraham Gitlow, Ben F. Singer and Joseph L. Fradkin, herein referred to as the purchasers, acting in behalf of Service Industrial Cleaners,

Inc., a Kansas corporation, formed on or about May 17, 1961, which corporation is hereinafter referred to as "Buyer."

Under the agreement, Service, as "Seller" and the named individuals, as "Purchasers" agreed to the sale and transfer to the purchasers or their assigns of all seller's inventory of the articles used in conducting the seller's rental service business, furniture and equipment, accounts receivable, interest in real property, name, routes, customers' patronage and goodwill

The price was computed in the contract as follows:

Inventory of rental items	$228,000
Furniture and equipment	88,500
Sweeping tools, mops and accessories	5,000
Good will and customer patronage	110,000
Real property	78,000
Total	$509,500

In addition, there was to be paid a sum equal to the trade accounts receivable at the close of business May 17, 1961, and prepaid items as of that date.

The parties also agreed that the foregoing price did not include new, unused and unwashed garments and rental service items, new and unused sweeping tools and washroom supplies, fuel, and new automobile and truck tires, and that there would be added to the price an amount equal to seller's cost of such items.

As of May 17, 1961, Anders entered into a covenant with the purchasers to refrain from competition with them or their corporation in the conduct of rental service or laundry business.

As of May 22, 1961, Service, then known as D. B. Anders, Inc., entered into an agreement with the pur-

chasers to a similar effect. As of the same date the corporation delivered to the buyer a bill of sale of certain of its assets. On or about May 22 or 23, 1961, the sale by the corporation of substantially all its assets to the buyer was completed.

Pursuant to the plan of liquidation the corporation distributed all its assets in complete liquidation to petitioner, its sole stockholder, within the 12-months period beginning May 12, 1961.

The corporation filed with the Secretary of State of the State of Kansas its resolution of dissolution in April, 1962, and its corporate existence ceased.

It is stipulated that the corporation is entitled to a deduction for depreciation on its building and improvements, machinery and equipment and office equipment for its taxable year ended July 31, 1961, in the amount of $7,370.77.

The corporation paid its Federal income taxes for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
October 13, 1961	$20,000.00
January 15, 1962	11,063.38

Petitioner paid additional Federal income taxes assessed against the corporation for its taxable year ended July 31, 1961, as follows:

Date Paid	Amount
May 27, 1963	$3,832.80
October 28, 1963	5,944.30

On its income tax return for the fiscal year ended July 31, 1961, the corporation reported a gain of $446,601.89 arising out of the sale of substantially all its assets to the

buyer, and claimed exclusion of such gain from taxable income under section 337, Internal Revenue Code of 1954. The gain reported included $233,000, which was the amount of the consideration received by Service from Buyer allocated to the items-in-use in its laundry rental business.

The inventory of rental items which were transferred in the sale had a basis of zero to the corporation.

OPINION

Petitioner owned all the stock of Service Industrial Cleaners, Inc., a Kansas corporation organized in 1947, which adopted a plan of liquidation in May, 1961, sold its property, changed its name to D. B. Anders, Inc., and within twelve months after the adoption of the plan distributed all of its assets in complete liquidation to him. The corporation duly filed a notice of dissolution and its existence ceased in April 1962. Petitioner received distributions in excess of the deficiency determined by respondent against the corporation for the taxable year ended July 31, 1961, and is admittedly liable as a transferee for such deficiency if the corporation is liable. Petitioner contends that under the provisions of section 337[1] no gain is to be recognized

1. SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property Defined.—

(1) In General.—For purposes of subsection (a), the term "property" does not include—

to the corporation from the sale of its property in liquidation in May 1961.

The parties are in agreement that the corporation adopted a plan of complete liquidation after June 22, 1954 (the date specified in section 337), sold its property and distributed all its assets within the 12-month period beginning on the date the plan was adopted. They further agree that the rental items involved were not stock in trade, property includable in inventory, or property held by the corporation for sale to customers in the ordinary course of its trade or business. On the basis of these facts, it appears that there was literal compliance with the requirements of section 337(a), and further, not being property specifically excluded by section 337(b)(1), that the rental items involved were property, the gain or loss from the

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(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) Nonrecognition With Respect to Inventory In Certain Cases.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) such property so sold or exchanged, and

(B) installment obligations acquired in respect of such sale or exchange.

sale of which is not to be recognized to the corporation under section 337(a). See section 1.337-3, Income Tax Regulations; Rev. Rule. 59-120, 1959-1 C.B. 74.

Respondent contends, however, that $233,000 of the total consideration received by the corporation on the sale is includable in the taxable income of the corporation in the year of receipt, on the ground that this amount was for rental items which had previously been expensed by the corporation and it had received full tax benefit therefrom. On brief, respondent states that he "relies on the well established rule that if an amount deducted from gross income in one taxable year is recovered in a later year, the recovery is income in the later year." The rule referred to is commonly known as the "tax-benefit" rule or doctrine.

The "tax-benefit" rule was originally developed through court decisions. Mertens, Law of Federal Income Taxation (1962 Revision) section 7.34; *Estate of William H. Block*, 39 B.T.A. 338 (1939), affd. sub nom *Union Trust Co. of Indianapolis* v. *Commissioner*, 111 F. 2d 60 (C.A. 7, 1940), certiorari denied 311 U.S. 658; *Budd Company v. United States*, 252 F. 2d 456, 458 (C.A. 3, 1957). Though not expressly stated in the Code, it has received indirect statutory recognition, specifically with respect to bad debts, prior taxes and "delinquency" amounts in section 22(b)(12) of the 1939 Code, substantially re-enacted as section 111 of the 1954 Code.[2]

2. SEC. 111. RECOVERY OF BAD DEBTS, PRIOR TAXES, AND DELINQUENCY AMOUNTS.

(a) General Rule.—Gross income does not include income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount.

(b) Definitions.—For purposes of subsection (a)—

* * *

T. O. McCamant, 32 T.C. 824. The "rule of exclusion" prescribed by the statute has been extended by Treasury Regulations[3] to "all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years * * *." For the purposes of the present case, it is not necessary to express any opinion as to whether or not the cited regulation is an unauthorized extension of the otherwise limited Congressional approval of the "tax-benefit" doctrine and we refrain from doing so. See, however, *Alice Phelan Sullivan Corp.* v. *United States*, ... F.2d ..... (Ct. Cl. July 20, 1967).

Assuming, for the purposes of this case, that the amount in question represents the recovery of expenses previously deducted from gross income by the corporation and that such recovered amount would be taxable to

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(4) Recovery Exclusion.—The term "recovery exclusion," with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Secretary or his delegate, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this subtitle * * * reduced by the amount excludable in previous taxable years with respect to such debt, tax, or amount under this section.

3. Section 1.111-1, Income Tax Regs., provides as follows:

Sec. 1.111-1 Recovery of certain items previously deducted or credited.

(a) General. Section 111 provides that income attributable to the recovery during any taxable year of bad debts, prior taxes, and delinquency amounts shall be excluded from gross income to the extent of the "recovery exclusion" with respect to such items. The rule of exclusion so prescribed by statute applies equally with respect to all other losses, expenditures, and accruals made the basis of deductions from gross income for prior taxable years, including war losses referred to in section 127 of the Internal Revenue Code of 1939, but not including deductions with respect to depreciation, depletion, amortization, or amortizable bond premiums. The term "recovery exclusion" as used in this section means an amount equal to the portion of the bad debts, prior taxes, and delinquency amounts (the items specifically referred to in section 111), and of all other items subject to the rule of exclusion which, when deducted or credited for a prior taxable year, did not result in a reduction of any tax of the taxpayer under subtitle A * * *

the corporation in the year of recovery under other circumstances, it is nevertheless gain which resulted to the corporation from the sale of all its assets pursuant to a plan of complete liquidation and is nonrecognizable to *the corporation* under the provisions of section 337.

Respondent contends that by the enactment of section 337, Congress never intended the realization of such income to escape taxation at the corporate level.

The provisions of section 337 first appeared in the Internal Revenue Code of 1954. Their primary purpose was to eliminate the uncertainties attendant upon the Supreme Court decisions in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945), and *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950), and to permit a liquidating corporation to make a tax-free sale of all its assets with but a single tax being imposed at the stockholder level without regard to the form of the transaction. H. Rept. No. 1337, 83d Cong., 2d Sess., p. A106; *Bird Management, Inc.*, 48 T.C. 586; *Frank W. Verito*, 43 T.C. 429; *Mountain Water Co. of La Crescenta*, 35 T.C. 418.

Where, as here, application of the "tax-benefit" rule would contravene the clear and unambiguous provisions of section 337(a), we think it should not be applied. As was stated by the Supreme Court in *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, 240 (1955), "where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall."

In support of his contention that the "tax-benefit" rule is applicable here, respondent has cited Rev. Rul.

61-214, C.B. 1961-2, 60, wherein it was held that a portion of the proceeds received by an office building corporation, in a sale in complete liquidation, for a stock-pile of coal, plumbing supplies and small tools, the cost of which had been deducted in prior years, was to be treated as ordinary income under section 61 and not as nonrecognized gain under section 337(a)).[4]

This ruling is no more than an expression of the opinion or position of the Internal Revenue Service with respect to the law applicable to the facts recited therein and does not have the force of law. See the preface to the Cumulative Bulletin; "The Four R's: Regulations, Rulings, Reliance and Retroactivity," by Mitchell Rogovin, then Chief Counsel, Internal Revenue Service, 43 Taxes 756; *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766, 768; *Radiant Glass Co.* v. *Burnett*, 54 F. 2d 718, affirming 16 B.T.A. 610; *Bush #1 c/o Stonestreet Lands Co.*, 48 T.C. 218, 232.

Though noted "without comment" in *Hollywood Baseball Association*, 42 T.C. 234 (footnote 6, p. 262), affd. 352 F. 2d 350 (C.A. 9, 1965), vacated and remanded 383 U.S. 824, Rev. Rul. 61-214 has not to our knowledge been approved by any court. The conclusions reached are not supported by the authorities cited therein, are clearly contrary to the provisions of section 337(a) and, in our opinion, are not a valid interpretation of the statute. See Gutkin and Beck, "Section 337: IRS wrong in taxing, at time of liquidation, items previously deducted." 17 Jonrnal of Taxation 146.

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4. In Rev. Rul. 59-308, C.B. 1959-2, 110, respondent held that no taxable gain was to be recognized by a corporation, under section 337, from the sale during the period of liquidation of emergency facilities amortized under section 168 of the Code. In the stated case the property had been completely amortized. In that ruling respondent conceded that the facilities, not having been specifically excluded from the definition of "property" as used in section 337, were included in that term.

In *Central Building & Loan Association*, 34 T.C. 447 (1960), the assets sold in the liquidation sale included notes receivable on which certain interest had been earned to the date of sale. This Court held there was a collection of interest rather than a "sale or exchange" of property and that such amount was not subject to nonrecognition under section 337.

In *Commissioner* v. *First State Bank of Stratford*, 168 F. 2d 1004 (C.A. 5, 1948), reversing 8 T.C. 831, certiorari denied 335 U.S. 867, a bank voted to declare a dividend in kind and distributed to its shareholders certain notes which had been charged off as worthless. At the time of distribution substantial collections had been effected on the notes and further substantial collections were effected after distribution. The Court of Appeals held the bank taxable under the anticipatory assignment of income rule. Obviously, section 337, enacted some six years later, was not involved, nor was there a "sale or exchange" of property in partial or complete liquidation.

Neither of these two cases which were cited in Rev. Rul. 61-214, support the ruling or respondent's contention with respect to the application of the "tax-benefit" rule to a sale in complete liquidation under section 337. Nor do any of the other cases cited by respondent on brief.

In *Commissioner* v. *Kuckenberg*, 309 F. 2d 202 (C.A. 9, 1962), modifying 35 T.C. 473 (1960), certiorari denied 373 U.S. 909, the Court of Appeals rejected the view that section 337 prevented the gain realized by a liquidating corporation from the sale of completed contracts from being taxable to the corporation and treated the transaction as an anticipatory assignment of earned income.

In *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35 (C.A. 4, 1965), affirming in part and reversing in part 42 T.C. 510,

certain proceeds received for the assignment of uncompleted sales contracts for pre-fabricated houses were held not to be exempt under section 337. The Court of Appeals referred to the Tax Court holding that the sale of the contracts constituted an anticipatory assignment of income and stated:

> The uncompleted sales contracts not being capital assets, the proceeds received for their assignment are to be taxed as ordinary income.

West Seattle National Bank of Seattle, 33 T.C. 341 (1959), affd. 288 F. 2d 47 (C.A. 9, 1961), and *J. E. Hawes Corp.*, 44 T.C. 705 (1965), both involved sales of accounts receivable with respect to which reserves for bad debts had been deducted. It was held that the amount received equal to the bad debt reserves was ordinary income and section 337 did not apply because the income sought to be taxed did not represent gain from the sale of assets.

In the instant case, the rental items were the *operating assets*,—property used to generate income. They were the trees, not the fruit. The sale was of assets, not income. The fact that their income-producing potential had not been exhausted when sold did not alter their character as property used in the business of the corporation. There is no evidence of stockpiling or that the supply of rental items was not reasonable. Replacements were purchased only as needed and the business required. They were as much property used in the trade or business as the machines used to wash them or the trucks used to transport them.

Respondent has not questioned the propriety of expensing the rental items when purchased, or the fact that they were not inventoried. See section 446 (a) and (c), Internal Revenue Code of 1954; Income Tax Regulations, section 1.446-1(c)(iv); section 471, Internal Revenue Code of 1954; Income Tax Regulations, section 1.471-1.

See also *Smith Leasing Co.*, 43 T.C. 37, wherein this Court held that respondent could not require the setting up of an inventory as of the end of the year preceding liquidation.[5]

The fact that the cost of the rental items had previously been expensed does not preclude the nonrecognition of gain *to the corporation* under section 337. While there is nothing in the legislative history to indicate Congress was aware of the fact pattern of this case, the language of the statute is clear and unambiguous. If the result here is undesirable, the remedy is for Congress, not the courts. Cf. *Commissioner* v. *South Lake Farms, Inc.*, 324 F. 2d 837, 840 (C.A. 9, 1963), affirming 36 T.C. 1027. Whatever may have been the initial intention in enacting section 337, it contains no requirements other than those spelled out. Cf. *Estate of Hugh Miller*, 48 T.C. 265. In our opinion, the rental items were "property" within the definition of section 337(b)(1) and there was a "sale" of such property on or about May 22 or 23, 1961, when the transfer by Service of all its assets to Buyer was completed, pursuant to a plan of complete liquidation and the agreement of sale. Accordingly, we hold that the gain from the sale of the rental items is not to be recognized to the corporation.

In view of our holding that such gain is not to be recognized to the corporation, it follows that petitioner is not liable as transferee.

Decision will be entered under Rule 50.

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5. In this connection, it is to be noted that had the rental items-in-use been inventoried, section 337(b)(2) would have required the nonrecognition of gain *to the corporation.*

APPENDIX B-2

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

MAY 1969 TERM

No. 9,987

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

D. B. ANDERS,
Respondent.

On Petition for Review of Decision of the Tax Court of the United States

(Filed June 20, 1969)

Melva M. Graney, Department of Justice, Washington, D. C. (Mitchell Rogovin, Assistant Attorney General, and Lee A. Jackson and Meyer Rothwacks, Attorneys, Department of Justice, Washington, D. C., were with her on the brief) for Petitioner.

J. Glenn Hahn, Kansas City, Missouri (Hoskins, King, Springer, McGannon and Hahn, and Harlow B. King and Walter J. Kennedy, and Davis, Graham and Stubbs, and Robert H. Harry were with him on the brief) for Respondent.

Before PICKETT, Senior Circuit Judge, and HICKEY and HOLLOWAY, Circuit Judges.

HOLLOWAY, Circuit Judge.

This petition for review challenges the decision against the Government by the Tax Court in Anders v. Commissioner, 48 T. C. 815 (1967). The issue involved is whether the amount received for rental items of apparel, towels and the like in a sale of corporate assets preceding a complete liquidation was a gain from the sale of property within the provisions of §337 of the Internal Revenue Code of 1954 for non-recognition of gain to the corporation where the cost of such items had been fully expensed when they were purchased, or whether such gain was taxable as ordinary income to the corporation under tax benefit principles. The Government contends that due to the tax benefit obtained when the charges to expense accounts were made, the gain should be treated as ordinary income. The taxpayer[1] maintains that tax benefit principles do not apply and that there was only a gain from the sale of property within the non-recognition provisions of §337 on liquidations. The Tax Court sustained the taxpayer's position.

The undisputed facts show the following. Service Industrial Cleaners, Inc., (Service) was a Kansas corporation engaged in the business of providing a rental service of laundered towels, seat covers, wiping and dusting materials, coveralls, coats, shirts and other items of apparel. The items had a useful life of 12 to 18 months or somewhat longer depending on the use made of them. Service also carried on a general cleaning and laundering business for such items owned by others and an industrial laundry business. For Federal income tax purposes Service charged the full cost of the rental items described to expense accounts when purchased pursuant to Treasury Regulation §1.162-3 as a cost of materials and supplies. The

1. It is undisputed that respondent Anders as a stockholder received distributions in excess of the deficiency asserted against the corporation and would be liable as transferee if the corporation is liable for the deficiency.

expensed replacement cost of the rental items ran about $200,000 annually. At the end of its tax years the expense accounts were credited with the cost of items not placed in service during the year. There is no dispute as to the propriety of these charges.

In May, 1961, respondent Anders, owner of the stock of Service directly or through nominees, made an agreement for the sale of the business and properties of Service. On May 12 Service's directors and stockholders passed resolutions approving the terms of sale and adopting a plan of complete liquidation pursuant to §337. On May 16 Service executed a written agreement of sale with the individuals purchasing the business who were acting in behalf of a newly formed Kansas corporation also known as Service Industrial Cleaners, Inc., through which purchasers desired to carry on the business. On May 22 and 23 the rentals items in question and substantially all of Service's assets were sold to the purchasers. Compliance by Service with the requirements of §337 for such complete liquidations is not disputed. Moreover the parties agree that the rental items in question were not stock in trade or property includible in inventory or held for sale to customers so as to be excluded from the provisions of §337(b)(1)(A).

In the terms of sale Service agreed with the purchasers on specific consideration to be paid for the inventory of rental items in question and also specified consideration to be paid for furniture, realty, goodwill and accounts receivable. For the purposes of this opinion it is sufficient to note that Service reported a gain of $446,601 from the sale of all such property and claimed non-recognition of the gain under §337. This gain included $233,000 received for the rental items in use whose cost had been fully expensed giving them a zero basis. It is this gain from dis-

position of the rental items in use which the Government says should be taxed as ordinary income due to tax benefits obtained when the cost of the rental items was charged to expense on purchase. The tax return of Service in issue was on an accrual basis.

The Government position essentially is that §337 carries the same exceptions and limitations applicable to capital gains treatment under the Code generally, which is shown by similar definitions of property in §337 and of capital assets in §1221 and other statutory provisions;[2]

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2. §337 of the Internal Revenue Code of 1954 provided in pertinent part:

"SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

(a) General Rule.—If—

(1) a corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) Property Defined.—

(1) In General.—For purposes of subsection (a), the term 'property' does not include—

(A) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (A) of this paragraph, and

(C) installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation. * * *"

that such exceptions include decisions imposing ordinary income taxation under the tax benefit rule where an amount deducted from gross income in one year is recovered in a later year; that under these principles the proceeds from the disposition of the rental items should be treated as ordinary income against which the expense of purchasing the items was charged; and that where there is no gain representing appreciation in value there is no basis for affording the transaction treatment as a gain entitled to non-recognition under §337.

The taxpayer's position in substance is that there was a sale of items constituting property within the broad definition of that term in §337 and not covered by its specified exclusions; that the tax benefit cases are of limited application, those involving anticipatory assignment of income and others relied on by the Government being inapposite, and that, in any event, the deductions taken by Service on

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In the part of the 1954 Code providing "General Rules In Determining Capital Gains And Losses," §1221 provided in pertinent part:

"SEC. 1221. CAPITAL ASSET DEFINED.

For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copy right, a literary, musical, or artistic composition, or similar property, held by— * * *"

The Government also relies on §111 of the 1954 Code which imposed certain restrictions on application of the tax benefit rule. This provision is said to evidence legislative approval of decisions fashioning the rule. Reference is also made to a ruling which denied treatment as a non-recognizable gain in a §337 liquidation involving the sale of coal, plumbing supplies and small tools. See Rev. Rul. 61-214, 1961-2 Cum. Bull. 60.

purchase of the rental items were in the nature of depreciation deductions and not subject to recapture.

In rejecting the Government's contentions the Tax Court stated:

> "Assuming, for the purposes of this case, that the amount in question represents the recovery of expenses previously deducted from gross income by the corporation and that such recovered amount would be taxable to the corporation in the year of recovery under other circumstances, it is nevertheless gain which resulted to the corporation from the sale of all its assets pursuant to a plan of complete liquidation and is nonrecognizable *to the corporation* under the provisions of section 337." (48 T. C. at 820-821)

We do not interpret §337 as having the special effect on this transaction which the Tax Court finds. If "under other circumstances" (*i.e.*, the sale of the rental items in question without a §337 liquidation) the tax benefit rule and similar principles would have made the proceeds from the sale of such property taxable as ordinary income, they should also be taxable as ordinary income here. In §337 Congress dealt with the problem of taxation on gain to both the corporation and its stockholders where a sale of assets and subsequent liquidation occur, arising from the decisions in Commissioner v. Court Holding Co., 324 U.S. 331 (1945), and United States v. Cumberland Public Service Co., 338 U.S. 451 (1950).[3] And the means employed was to provide for non-recognition of the gain to the corporation on the sale of property (as defined in §337) by it before its liquidation. The statute used a definition of property in §337 parallel to that of assets in §1221 of the

3. See S. Rep. No. 1622, 83d Cong., 2d Sess. 258 (1954); H.R. Rep. No. 1337, 83d Cong., 2d Sess. A106 (1954); Pridemark, Inc. v. Commissioner, 345 F.2d 35 (4th Cir. 1965); and Commissioner v. Kuckenberg, 309 F.2d 202 (9th Cir. 1962), cert. denied, 373 U.S. 909 (1963).

1954 Code.[4] Moreover, there is no provision in the statute showing an intent to alter or bar the application in cases under §337 of tax benefit principles fashioned under other provisions of the Code. Therefore, we conclude that tax benefit principles are applicable here as under other statutory provisions and that §337 intended no disregard of them in liquidation cases. See Citizens Federal Savings & Loan Association of Cleveland v. United States, 290 F.2d 932 (Ct. Cls. 1961), and West Seattle National Bank of Seattle v. Commissioner, 288 F.2d 47 (9th Cir. 1961).

We turn to a consideration of this case under tax benefit principles. The rental items in question had a zero basis and their cost had been fully expensed on purchase by Service in its Federal income tax returns under Treasury Regulation §1.162-3, set out in the margin.[5] In similar circumstances a recovery of property by the taxpayer was treated as recoupment of prior charitable deductions and as taxable income. Alice Phelan Sullivan Corporation v. United States, 381 F. 2d 399, 402 (Ct. Cls. 1967). In view of Service's charging the full

4. See Pridemark v. Commissioner, supra at 45, and Merchants National Bank of Mobile v. Commissioner, 199 F.2d 657 (5th Cir. 1952), applying the tax benefit rule and denying capital gains treatment under the predecessor to §1221.

5. Service fully expensed the cost on purchase of the rental items under Treasury Regulation §1.162-3, pertaining to "Cost of Materials." which provided;

> "Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only in the amount that they are actually consumed and used in operation during the taxable year for which the return is made, provided that the costs of such materials and supplies have not been deducted in determining the net income or loss or taxable income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and to deduct from gross income the total cost of such supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method."

cost of the rental items to expense, the ". . . increment realized in this area over and beyond adjusted basis does not then represent any gain in capital or asset value." West Seattle National Bank of Seattle v. Commissioner, supra at 49. The *West Seattle* case involved the transfer of loans receivable at face value with recoupment thereby effected of prior bad debt charges. We conclude that the logic of tax benefit principles applies here, despite various distinctions suggested between Service's case and existing tax benefit decisions. Under such principles the proceeds of the rental items should properly be treated as recoupment of the expense charges. See Alice Phelan Sullivan Corporation v. United States, supra; Citizens Federal Savings & Loan Association of Cleveland v. United States, supra; West Seattle National Bank of Seattle v. Commissioner, supra; Commissioner v. First State Bank of Stratford, 168 F. 2d 1004 (5th Cir. 1948), cert. denied, 335 U.S. 867 (1948); Merchants National Bank of Mobile v. Commissioner, supra, at 659 (taxing proceeds of sale of notes charged off to a zero basis); William Eugene Monday, Jr., 16 T. C. M. 1, affirmed per curiam, 252 F. 2d 789 (6th Cir. 1958), cert. denied, 358 U.S. 883 (1958); Lloyd H. Faidley, 8 T. C. 1170 (1947).[6]

The taxpayer maintains that such principles may not apply since the rental items in question come literally within the general meaning of property in §337. Thus, it is argued, on disposition of the rental items the proceeds must be treated as gain from the sale of property. We do not agree. The fact that a transaction involves disposition of property does not compel treatment of the

6. But see Reynolds v. Boos, 188 F.2d 322 (8th Cir. 1951). Moreover, the Anders opinion has been followed and such tax benefit decisions held inapplicable in Spitalny v. United States, 288 F.Supp. 650 (D. Ariz. 1968), a §337 liquidation case involving charged off expenses of cattle feed and similar supplies.

proceeds as gain from such a transfer. Commissioner v. Gillette Motor Co., 364 U.S. 130, 134 (1960); United States v. Eidson, 310 F. 2d 111, 113-114 (5th Cir. 1962), modified on other grounds, 312 F.2d 744 (5th Cir. 1963); West Seattle National Bank of Seattle v. Commissioner, supra; cf. Dyer v. Commissioner, 294 F. 2d 123 (10th Cir. 1961) and Commissioner v. First State Bank of Stratford, supra. Instead, we conclude that tax benefit principles call for treatment of the proceeds not as gain from the sale of property, but as ordinary income which was deducted on its purchase.

The taxpayer contends further that the expense charges were the same as depreciation which is not subject to recapture, and that the proceeds of the rental items should be treated as gain from a sale above a depreciated basis at zero, relying on Fribourg Navigation Co., Inc. v. Commissioner, 383 U.S. 272 (1966).[7] However, the *Fribourg* case emphasizes that such treatment follows use of the depreciation method of tax accounting dealing with wear and tear or gradual expiration of the useful life of the property. Id. at 276; West Seattle National Bank of Seattle v. Commissioner, supra at 49. While some comparisons may be drawn between depreciation and the charges to expense made by Service at purchase of the rental items, we conclude that in substance the methods are not the same. By charging to expense the full cost of the rental items at purchase and not capitalizing them, there was no real depreciation method employed coming within the *Fribourg* case so as to qualify the disposition of the rental items for treatment as gain from a sale above a depreciated basis. There was no realization of ap-

7. In view of 26 U. S. C. A. §1245, this argument seems foreclosed for dispositions occurring in taxable years beginning after December 31, 1962, and involving depreciation deductions taken after December 31, 1961.

preciation in value entitled to such treatment. Commissioner v. Gillette Motor Co., supra at 134; Citizens Federal Savings & Loan Association of Cleveland v. United States, supra at 936.

As the taxpayer says, the controversy is not clearly decided by any of these cases. However, the recoupment of the charges involved here reasonably comes within the tax benefit principles and similar cases, and §337 does not alter or bar their application. In these circumstances we do not believe that treatment as a non-recognizable gain was intended by Congress.

The decision is reversed.

APPENDIX B-3

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

JULY 1969 TERM

No. 9987

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

D. B. ANDERS,
Respondent.

Order Denying Petition for Rehearing

(Filed August 6, 1969)

Melva M. Graney, Department of Justice, Washington, D. C. (Mitchell Rogovin, Assistant Attorney General, and Lee A. Jackson and Meyer Rothwacks, Attorneys, Department of Justice, Washington, D. C., were with her on the brief) for Petitioner.

J. Glenn Hahn, Kansas City, Missouri (Hoskins, King, Springer, McGannon and Hahn, and Harlow B. King and Walter J. Kennedy, and Davis, Graham and Stubbs, and Robert H. Harry were with him on the brief) for Respondent.

Before PICKETT, Senior Circuit Judge, and HICKEY and HOLLOWAY, Circuit Judges.

HOLLOWAY, Circuit Judge.

We have considered the petition for rehearing and conclude that it raises no material new issue. These comments are made due to Service's contentions, among others, that the opinion was based on reference to an incorrect regulation and that it did not discuss a pertinent alternative theory.

It is argued that the expensing of the cost of the rental items was not made under §1.162-3 of the Treasury Regulations on Income Tax dealing with the "Cost of Materials" as originally stated in the opinion. Instead, the taxpayer refers to the statement in the opinion of the Tax Court that: "Respondent has not questioned the propriety of expensing the rental items when purchased, or the fact that they were not inventoried. See sec. 446(a) and (c), I.R.C. 1954; sec. 1.446-1(c) (iv), Income Tax Regs.; sec. 471, I.R.C. 1954; sec. 1.471-1, Income Tax Regs." 48 T.C. at 823. §1.162-3 was cited by the Government brief, but we find no record proof that it was the regulation relied on by Service. The regulations cited by the Tax Court have general provisions on inventories and for use of the cash method for expense accounts by an accrual method taxpayer (which Service was) and others which do apply. We therefore consider what effect the applicability of the regulations cited by the Tax Court may have.

We note that the Tax Court findings, 48 T.C. at 816-818, in substance re-stated the following stipulation of the parties:

"6. For Federal income tax purposes Service charged to its expense accounts when purchased the cost of the items used in conducting the aforesaid rental service business. At the end of each taxable year the expense accounts were credited with the costs of the ending inventory of items which had not been placed in service at the end of such taxable year. In the sale of the business to Buyer, hereinafter referred to in paragraph 8 hereof, the sum of $233,000 of the consideration paid was allocated for the items in use."

We have considered the stipulation, the Tax Court findings to the same effect, the related facts and all the cited regulations. Accepting the proposition that Treasury Regulation §1.162-3 was not the basis of the taxpayer's expense charges, the result is the same. In any event the cost of the rental items was fully expensed at purchase and tax deductions therefor taken. The regulation permitting the deductions is not controlling. Therefore, as stated in the opinion, we conclude that under tax benefit principles the proceeds received for the rental items should properly be treated as recoupment of the prior deductions and as taxable income.

It is also contended that an alternative theory of the taxpayer was not considered. The argument is that if the rental items are not treated as property under §337(b), then they are entitled to treatment as stock in trade or other property includible in inventory under §337(b)(2). It is said that since the items were sold to one person in one transaction the taxpayer is still entitled to nonrecognition of the gain under §337(a).

The theory does not strengthen Service's position. We dealt with the contention that the rental items come literally within the general meaning of property in §337. As the opinion stated, we conclude that the fact that a transaction involves the disposition of property within the

meaning of §337 does not compel treatment of the proceeds from it as gain from a transfer of the property. The same reasoning applies if the property is treated as within the meaning of §337(b)(2). Where the cost of the property was fully expensed and deducted for tax purposes, tax benefit principles reasonably call for treatment of the proceeds as recoupment of the prior charges and ordinary income. By §337 Congress showed no intention to discard such principles.

The opinion is corrected by substituted pages 2, 3 and 8 to omit reference to Treasury Regulation §1.162-3. We also omit a statement, which followed one made in the Tax Court opinion, that the parties agreed that the rental items were not stock in trade, et cetera. This is done to show that the taxpayer has asserted the alternative theory under §337 (b) (2), discussed above.

We conclude that neither the grounds discussed above nor others urged warrant a rehearing or altering the decision. The petition for rehearing is denied.